

# **INDIANA DEPARTMENT OF STATE REVENUE**

## **Revenue Ruling #2002-02IT**

April 10, 2002

Notice: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by publication of a new document in the Indiana Register. The publication of this document will provide the general public with the information about the Department's official position concerning a specific issue.

### **ISSUES**

Gross Income Tax, Adjusted Gross Income Tax, and Supplemental Net Income Tax

Authority: IC 6-2.1-3-25, Rule 45 IAC 1.1-1-3, Rule 45 IAC 1.1-2-13, IC 6-2.1-1-16, Tax Policy Directive #2, IC 6-3-1-3.5, IC 6-2.5-2-1, IC 6-2.5-3-2, IC 6-2.5-4-1, IC 6-3-4-8

The taxpayer requests the Department to rule on various issues pertaining to two proposed business restructurings. The specific issues will be listed and addressed in the "Discussion and Rulings" portion of this ruling.

### **STATEMENT OF THE FACTS**

Taxpayer is incorporated and commercially domiciled in the State of Ohio. Taxpayer engages in the business of constructing single-family homes with its affiliates in several states, including Indiana. In Indiana, Taxpayer has resident employees, sales offices, and real and tangible personal property (hereinafter "Indiana assets"). Indiana employees perform activities related to home sales, construction management, land acquisition, zoning approvals, and other related activities. Under the proposed restructuring, the Indiana employees may or may not be transferred to another legal entity. Taxpayer hires subcontractors for the purpose of constructing the homes. Personnel located in the Ohio corporate headquarters are responsible for home design, marketing initiatives, and corporate management activities. In addition, corporate headquarters manages national relationships with various national vendors such as lumber and appliance suppliers. Supplies purchased under the national accounts are used to construct Indiana homes. Taxpayer currently files a separate Indiana corporate income tax return.

To minimize business risk and protect shareholder value, Taxpayer is proposing to restructure the manner in which it conducts business activities in the State of Indiana. A primary reason underlying the proposed restructuring is to minimize legal risks related to the Indiana home building operations. This is accomplished by transferring the Indiana operations (assets as well as employees) into a fully operational limited partnership. Through separating the Indiana operations into a separate legal entity, with separate legal owners, Taxpayer will minimize its legal exposure related to liabilities arising from the Indiana operations. In addition, Taxpayer can more accurately measure financial results related to the Indiana operations because these

operations are conducted within a separate legal entity. Taxpayer will benefit from minimizing its legal risks, and its shareholders will benefit from more accurate financial information regarding the Indiana operations. Finally, the Indiana operations will be organized for the purpose of making a profit from building residential homes in Indiana, which provides the proposed restructuring with additional business purpose.

Under the proposed restructuring, Taxpayer would contribute a ninety-nine percent (99%) undivided interest in its Indiana assets and related liabilities to a newly created single member limited liability company (SMLLC #1) in exchange for a one hundred percent (100%) membership interest in SMLLC #1. Taxpayer would also contribute the remaining one percent (1%) interest in its Indiana assets and related liabilities to another newly created single member limited liability company (SMLLC #2) in exchange for a one hundred percent (100%) membership interest in SMLLC #2. Pursuant to the Internal Revenue Code (IRC) under Treasury Regulation Section 301.7701-3(b)(ii), SMLLC #1 and SMLLC #2 will be disregarded as an entity separate from their owner, Taxpayer. For federal income tax purposes, the transactions are non-taxable as transfers from one division to another, and no gain or loss is recognized and the assets will have a carryover basis.

A newly created limited partnership (LP) will also be created under Indiana partnership statutes. SMLLC #1 and SMLLC #2 will contribute their undivided interests in the Indiana assets and related liabilities to LP. In return for the contribution, SMLLC #1 will receive a ninety-nine percent (99%) general or limited partnership interest and SMLLC #2 will receive a one percent (1%) general or limited partnership interest in LP.

For federal income tax purposes any income or loss earned by LP will be treated as if Taxpayer received it because both SMLLC#1 and SMLLC #2 are disregarded from their owner for federal income tax purposes and treated as branches of Taxpayer. For federal income tax purposes, the LP would be treated as if it were solely owned by Taxpayer, and also disregarded as an entity separate from its owner pursuant to Treas. Reg. Section 301.7701-3(b)(ii). Accordingly, for federal income tax purposes the income or loss of LP would be included as part of Taxpayer's federal taxable income.

## **DISCUSSION & RULINGS**

### **ISSUE #1:**

Whether the Department will recognize LP as a partnership for gross income tax purposes.

### **RULING #1**

The Department recognizes the existence of the LP for gross income tax purposes to the extent the partnership is created pursuant to all applicable Indiana statutes.

### **ISSUE #2:**

Whether the Department will impose gross income tax on LP.

### **RULING #2**

The Department rules that the LP will not be subject to gross income tax to the extent the LP is not a publicly traded partnership that is treated as a corporation for federal income tax purposes under Section 7704 of the Internal Revenue Code as provided by IC 6-2.1-3-25.

### **ISSUE #3:**

Whether the Department will treat SMLLC #1 and SMLLC #2 as disregarded entities or pass through entities not subject to gross income tax.

### **RULING #3**

Pursuant to IC 6-2.1-1-16, limited liability companies that have a single member and are disregarded as entities for federal income tax law purposes are not defined as gross income tax “taxpayers”. Further, Departmental Tax Policy Directive #2 provides that for Indiana income tax purposes LLCs are treated the same as they are for federal tax purposes. Therefore, the Department rules that the SMLLCs are both, not defined as gross income taxpayers and are disregarded entities for gross income tax, hence are not subject to gross income tax.

### **ISSUE #4:**

If the Department respects LP as a partnership for gross income tax, will the net income earned by the LP be treated as a partnership distribution from the limited and general partners to Taxpayer under the gross income tax

### **RULING #4**

The Department rules that, pursuant to Rule 45 IAC 1.1-1-3, distributions from the limited partner are taxed 100% to the Taxpayer at the rate of 1.2%. Pursuant to Rule 45 IAC 1.1-2-13, distributions from the general partner are apportioned, if applicable, and taxed at the rate of 1.2% at the taxpayer’s level.

### **ISSUE #5:**

Whether the Department will follow federal income tax treatment and disregard the SMLLCs and the LP from their owner, Taxpayer. If so, for adjusted gross income tax and supplemental net income tax will Taxpayer’s taxable income include all the income or loss, subject to apportionment, of all the entities described in this proposed restructuring, i.e., the group of entities will be treated as a single entity?

### **RULING #5**

Pursuant to IC 6-3-1-3.5, the departure point for calculation of the Indiana adjusted gross income tax and the supplemental net income tax for corporations is IRC Section 63 “taxable income”. This being the case, the Department rules, to the extent the SMLLCs and the LP are treated as disregarded entities for federal income tax purposes, the Taxpayer’s adjusted gross income tax and supplemental net income tax “taxable income” will include all income or loss, subject to apportionment, of all the entities described in the proposal set forth in the statement of facts, e.g., the two SMLLCs and the LP will be treated as a single entity.

### **ISSUE #6**

Whether any sales or use taxes will be due on the transfer of vehicles and other assets from Taxpayer to the SMLLCs or the LP.

### **RULING #6**

IC 6-2.5-2-1 and IC 6-2.5-3-2 impose sales/use tax on retail transactions made in Indiana and on tangible personal property stored, used or consumed in Indiana that was acquired in a retail transaction. IC 6-2.5-4-1 provides that a “retail transaction” is defined as the transfer of tangible personal property for consideration. The Department rules, to the extent that the LP is not a taxable event for federal income tax purposes, there is no consideration involved in the transfer. Therefore, no retail transaction is executed and no sales/use tax is due on the transfer of vehicles and other assets in proposed restructuring.

### **ISSUE #7**

If the Indiana employees are transferred to a new legal entity, which entity will be treated as the employer following the restructuring?

### **RULING #7**

IC 6-3-4-8 states that every employer making payments of wages subject to tax under IC 6-3 who is required under the provisions of the Internal Revenue Code to withhold, collect and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in the withholding instructions issued by the Department. It is clear then, every employer who is required under the provisions of the Internal Revenue Code to withhold, collect and pay over federal income tax on wages paid by the employer is required, also, to withhold Indiana state and county tax (if applicable) on these wages. Therefore, the Department rules, to the extent the Taxpayer and/or the LP are required to withhold federal income tax on wages paid, the Taxpayer and/or the LP are required to, also withhold Indiana state and county tax (if applicable) on these wages.

### **CAVEAT**

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer’s facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, changes in statute, a regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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